

Audit Report



REPORTING OF THE FY 1999
MILITARY RETIREMENT HEALTH BENEFITS LIABILITY
IN THE DOD FINANCIAL STATEMENTS

Report No. D-2000-141

June 9, 2000

Office of the Inspector General
Department of Defense

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IG

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June 9, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit of the Reporting of the FY 1999 Military Retirement Health Benefits
Liability in the DoD Financial Statements (Report No. D-2000-141)

We are providing this audit report for information and use. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report met the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson at (703) 604-9582 (DSN 664-9582) (crichardson@dodig.osd.mil) or Mr. Walter R. Loder at (703) 604-9534 (DSN 664-9534) (wrloder@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-141
(Project No. D2000FA-0043.002)

June 9, 2000

Reporting of the FY 1999 Military Retirement Health Benefits Liability in the DoD Financial Statements

Executive Summary

Introduction. This audit is part of the "Audit of the Compilation of Financial Data for Other Defense Organizations Into the FY 1999 DoD Agency-Wide Financial Statements" (Project No. D2000FA-0043). We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare annual audited financial statements. The FY 1999 DoD Agency-Wide financial statements included the financial statements of a reporting entity entitled "Other Defense Organizations-General Funds." The military retirement health benefits liability was reported on the Other Defense Organizations Balance Sheet. Military retirement health benefits are post-retirement benefits that DoD provides to military retirees and other eligible beneficiaries through the Purchased Care and DoD military treatment facilities. For FY 1998, DoD reported \$223.4 billion for the military retirement health benefits liability estimate. After the DoD Agency-Wide and the Federal Government FY 1998 financial statements were issued, the Office of the Actuary, DoD, revised the military retirement health benefits liability estimate to \$185.9 billion for FY 1998. The \$37 billion difference was primarily caused by using more complete and current data. For FY 1999, DoD brought forward the FY 1998 liability estimate and reported \$196.2 billion for the military retirement health benefits liability estimate. The \$196.2 billion unfunded liability represented 20 percent of the \$998.9 billion of liabilities included on the FY 1999 DoD Agency-Wide financial statements.

Objectives. Our objective was to determine whether the FY 1999 military retirement health benefits liability, as calculated by the Office of the Actuary, DoD, was properly reported by the Defense Finance and Accounting Service Indianapolis Center, Indianapolis, Indiana, on the FY 1999 Other Defense Organizations-General Funds financial statements. The objective was covered under Project No. D-2000FA-0043. See Appendix A for a discussion of the audit scope and methodology and a summary of prior coverage related to the audit objective.

Results. The Defense Finance and Accounting Service Indianapolis Center did not properly record and report the FY 1999 military retirement health benefits liability estimate. As a result of accounting transactions made by the Defense Finance and Accounting Service Indianapolis Center, the military retirement health benefits liability was overstated by \$10.3 billion, the cumulative results of operations were overstated

by \$6.4 billion on the Balance Sheet, and program costs were overstated by \$16.7 billion on the Statement of Net Cost of the FY 1999 Other Defense Organizations-General Funds financial statements. The overstatements materially affected the FY 1999 DoD Agency-Wide financial statements. See the Finding section for details of the audit results.

Summary of Recommendations. We recommend that the Director, Defense Financial Accounting Service Indianapolis Center, make adjustments in the FY 2000 DoD Agency-Wide financial statements to correct the overstatements of the FY 1999 liability and its related expenses, and consult with the Under Secretary of Defense (Comptroller) to determine how to treat and record the military retirement health benefits liability.

Management Comments. The Defense Financial Accounting Service concurred with the finding and recommendations, stating that the Defense Financial Accounting Service will correct the overstatement of the military retirement health benefits liability as a prior period adjustment for the FY 2000. The Defense Financial Accounting Service will also work with the Office of the Under Secretary of Defense (Comptroller) to develop better guidance for recording the military retirement health benefits liability. See the Finding section for a discussion of management comments, and the Management Comments section for the text of the comments.

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Background

Reporting Requirements. Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD to prepare annual audited financial statements. In addition, the Federal Financial Management Act of 1994 requires the Secretary of the Treasury, in coordination with the Director, Office of Management and Budget, to prepare Government-wide financial statements.

The FY 1999 DoD Agency-Wide financial statements include financial statements for a reporting entity entitled "Other Defense Organizations-General Funds" (referred to in this report as Other Defense Organizations.) Other Defense Organizations is a consolidation of financial information from various Defense organizations and funds that use the Treasury Index symbol 97 (Department 97), including the Military Departments. The Inspector General, DoD, is not required to render a separate opinion on the financial statements for Other Defense Organizations. However, information from audits of the financial statements of Other Defense Organizations contributed to the disclaimer of opinion on the FY 1999 DoD Agency-Wide financial statements.

Defense Finance Accounting Service Responsibilities. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Financial Statements," October 1999, requires the Defense Finance and Accounting Service (DFAS) to ensure that the preparation of financial reports is consistent, timely, and auditable, and that controls are in place to ensure the accuracy of the reports. Beginning in FY 1996, the DFAS Indianapolis Center, Indianapolis, Indiana, was responsible for consolidating financial data for the Other Defense Organizations, compiling the data, and preparing the financial statements for Department 97 funds.

In compiling and preparing the financial statements for Other Defense Organizations, the DFAS Indianapolis Center did the following:

- obtained fiscal year-end trial balances and other financial information from the supporting accounting offices,
- consolidated the financial information received,
- made year-end departmental adjustments to post financial data to the accounting records, and
- made summary adjustments to change general ledger account balances to agree with the applicable balances shown on the year-end certified "Report on Budget Execution for TI [Treasury Index] 97 Appropriations" and other information received from Other Defense Organizations.

Office of Management and Budget Guidance. Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," as amended on November 20, 1998, provides guidance to agencies on the preparation of financial statements. The Bulletin establishes guidance for reporting pensions, other retirement benefits, and other post-employment benefits. Other retirement benefits in DoD include all retirement benefits other than pension plan benefits. The Bulletin further states that the entities responsible for accounting for other retirement benefits should calculate and report the liabilities and related expenses in accordance with the Statement of Federal Financial Accounting Standard No. 5, "Accounting for Liabilities of the Federal Government," September 1995.

DoD Financial Management Regulation. DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 6B, "Form and Content of the Department of Defense Financial Statements," chapter 2, "General Instructions for the Financial Statements," October 1999, requires the DFAS, in coordination with the DoD Components, to prepare financial statements. Beginning in FY 1996, the DFAS Indianapolis Center was responsible for preparing the financial statements for Treasury Index 97 funds. Other Defense Organizations is a consolidation of financial information from various Defense organizations and funds that use the Treasury Index 97 symbol. Chapter 4, "Balance Sheet," states that the military retirement health benefits liability will be reported on the Other Defense Organizations Balance Sheet.

Joint Review. A DFAS memorandum, "Department of Defense Other Defense Organizations General Fund Fiscal Year 1999 Financial Statements," December 6, 1999, provides for a joint review to resolve issues and obtain concurrence on changes to the financial statements and notes. All involved parties – including the Office of the Under Secretary of Defense (Comptroller), customers, responsible managers, DFAS headquarters and the DFAS Centers, and auditors – will have an opportunity to consistently and cooperatively improve the statements and notes. The Office of the Actuary, DoD (referred to in this report as the Actuary, DoD,) is responsible for the military retirement health benefits liability estimate.

The Actuary, DoD. The Actuary, DoD, is responsible for applying theories and techniques of actuarial science to DoD compensation systems, the largest of which is the military retirement system. The Actuary, DoD, prepares an annual actuarial valuation of the liabilities of the DoD Military Retirement Trust Fund, from which military retirement benefits are paid. The Actuary, DoD, is also responsible for the valuation of the military retirement health benefits liability estimate.

Objective

Our objective was to determine whether the FY 1999 military retirement health benefits liability, as estimated by the Actuary, DoD, was properly reported by the DFAS Indianapolis Center on the FY 1999 Other Defense Organizations financial statements. Management control program was discussed in other reports. See Appendix A for a discussion of the audit scope and methodology and a summary of prior coverage related to the audit objective.

FY 1999 Military Retirement Health Benefits Liability

The DFAS Indianapolis Center did not properly record and report the FY 1999 military retirement health benefits liability estimate. The condition occurred because the DFAS Indianapolis Center did not properly record a prior period adjustment for FY 1999 and did not adequately coordinate the reporting of the FY 1999 military retirement health benefits liability estimate with the Actuary, DoD, and the Office of the Under Secretary of Defense (Comptroller). As a result, the military retirement health benefits liability estimate was overstated by \$10.3 billion, the cumulative results of operations were overstated by \$6.4 billion on the Balance Sheet, and program costs were overstated by \$16.7 billion on the Statement of Net Cost, as reported on the FY 1999 Other Defense Organizations financial statements. The overstatements also affected the FY 1999 DoD Agency-Wide financial statements.

Preparation of the Military Retirement Health Benefits Liability Estimate

FY 1997 was the first year that the military retirement health benefits liability estimate (hereafter referred to as the liability estimate) was reported on the DoD-wide consolidated financial statements. Numerous problems were discovered in the methodology and data used in preparing the initial liability estimate. The problems generated high-level concern in DoD and the General Accounting Office because of the effects on the DoD Agency-Wide financial statements and the Government-Wide financial statements. Since then, an extensive review process and implementation strategy have been devised by the Office of the Assistant Secretary of Defense (Health Affairs), the Under Secretary of Defense (Comptroller), and the Actuary, DoD. The review process and implementation strategy are designed to eventually generate a reliable liability estimate.

For FY 1998, DoD reported \$223.4 billion for the liability estimate. In November 1999, the Actuary, DoD, revised the liability estimate and concluded that it should have been \$185.9 billion for FY 1998. The \$37.5 billion difference was primarily caused by using more complete and current data. For FY 1999, the Actuary, DoD, brought forward the recalculated FY 1998 liability estimate of \$185.9 billion and reported \$196.2 billion for the liability estimate. The \$196.2 billion unfunded liability represented 91 percent of the \$215.8 billion of the liabilities on the FY 1999 Other Defense Organizations financial statements and 20 percent of the \$998.9 billion of liabilities included on the FY 1999 DoD Agency-Wide financial statements.

Calculation of FY 1999 Liability Estimate. The FY 1999 liability estimate was based on a recalculated FY 1998 liability estimate. The original FY 1998

estimate of \$223.4 billion was recalculated by the Actuary, DoD, using more complete data. The recalculation decreased the FY 1998 estimate by \$37.5 billion. For FY 1999, the DFAS Indianapolis Center was required to record the FY 1999 liability estimate, including a prior period adjustment for the recalculated FY 1998 liability. The table below summarizes the calculation of the FY 1999 liability by the Actuary, DoD.

Calculation of the FY 1999 Military Retirement Health Benefits Liability	
<u>Calculation of the Military Retirement Health Benefits Liability</u>	<u>Amount (\$ in billions)</u>
FY 1998 liability reported	223.4
Prior period adjustment (actuarial decrease)	(37.5)
Recalculated FY 1998 liability	185.9
Liability expense for current period (FY 1999)*	16.7
Benefit payment for FY 1999	(6.4)
FY 1999 liability	196.2
<p>*This amount is the program benefit cost calculated by the Actuary, DoD, for FY 1999. It includes period interest for the liability of \$12 billion and service cost of \$4.7 billion, for a total of \$16.7 billion. Interest cost is the amount of imputed interest that would be charged in FY 1999 on the outstanding liability. Service cost is the amount of medical health entitlement that current Service members earned in FY 1999.</p>	

FY 1999 Liability Estimate Recorded. The DFAS Indianapolis Center did not correctly record and report the liability and its related expenses for FY 1999. The DFAS Indianapolis Center's initial accounting transactions recording the liability estimate did not classify the change in the FY 1998 liability estimate as a prior period adjustment. The DFAS Indianapolis Center transactions also duplicated \$6.4 billion of prior period benefit expense. Before the preparation of the Other Defense Organizations financial statements and the DoD Agency-Wide financial statements, auditors from the Inspector General (IG), DoD, provided the correct accounting transactions to the DFAS Indianapolis Center. Appendix B lists the incorrect accounting transactions prepared by the DFAS Indianapolis Center and the correct accounting transactions for recording the liability estimate for FY 1999.

Prior Period Adjustment. The correct transactions would have classified the change in the FY 1998 liability estimate as a prior period adjustment that affected only the FY 1999 Balance Sheet. Initially, accounting transactions at the DFAS Indianapolis Center classified the change in the FY 1998 liability estimate as FY 1999 current operating expense on the FY 1999 Statement of Net Costs. On approval from the Under Secretary of Defense

(Comptroller), the DFAS Indianapolis Center recorded the change in the FY 1998 liability estimate as a prior period adjustment. However, because the DFAS Indianapolis Center did not record transactions that would correct the FY 1999 current operating expense on the Statement of Net Costs, the prior period adjustment was recorded incorrectly.

Duplicate Benefit Expense. The Actuary, DoD, reported to the DFAS Indianapolis Center \$6.4 billion in payments for medical care benefits incurred by retirees for FY 1999.

Normal Accounting for Benefits Payment. In accounting practice, the service cost expenses that create the liability are usually recorded in one accounting period, and the actual payments for the expense are recorded in subsequent periods. Normally, the benefit payments are recorded as a reduction to the liability and not as an expense or a change in cumulative results of operations in the period when the payments were made. The \$6.4 billion benefit payment incurred in FY 1999 was for expenses already included in prior period service costs. Therefore, the \$6.4 billion is a reduction to the liability for the current year, not an expense.

DFAS Indianapolis Center's Accounting for Benefits Payment. During the current operating year, FY 1999, the \$6.4 billion benefits payment was captured as an expense in the Defense Health Program trial balance. The DFAS Indianapolis Center recorded the \$6.4 billion as an increase in cumulative results of operations (an equity account) without explanation. This was incorrect; DFAS should have reduced the FY 1999 Defense Health Program cost and liability by \$6.4 billion. Although this amount was paid for retirement health care in FY 1999, the related service cost was expensed in the prior period.

Coordination in Reporting the Liability

DFAS and the Actuary, DoD. DFAS did not adequately coordinate with the Actuary, DoD, in reporting the FY 1999 liability estimate. In November 1999, the Actuary, DoD, reported the \$37.5 billion decrease in the FY 1998 liability estimate to DFAS headquarters. DFAS headquarters should have instructed the DFAS Indianapolis Center to record a prior period adjustment to the FY 1999 financial statements. However, the failure to record the \$37.5 billion decrease in the FY 1998 liability estimate could have been corrected if the DFAS Indianapolis Center had coordinated with the Actuary, DoD.

According to DFAS guidance, financial statements and notes should be jointly reviewed by all involved parties, such as responsible managers, DFAS personnel, and auditors. The Actuary, DoD, is responsible for the valuation of the liability estimate. The Actuary, DoD, was not consulted as part of the joint review of the FY 1999 DoD Agency-Wide financial statements. Because of this oversight, the overstatement of the liability estimate by \$10.3 billion was not noted, and therefore was not corrected. In addition, if the DFAS Indianapolis

Center had adequately coordinated with the Actuary, DoD, the \$37.5 billion change in the FY 1998 liability estimate would have been originally recorded as a prior period adjustment.

DFAS and the Office of the Under Secretary of Defense (Comptroller). We reviewed a draft of the FY 1999 Other Defense Organizations financial statements and related accounting transactions prepared by the DFAS Indianapolis Center to record the liability estimate. On January 13, 2000, after reviewing the draft, we recommended that the DFAS Indianapolis Center adjust accounting transactions to properly record the liability estimate. Our recommendation included recording the \$37.5 billion change in the FY 1998 liability estimate as a prior period adjustment. On approval from the Under Secretary of Defense (Comptroller), the DFAS Indianapolis Center recorded the change in the FY 1998 liability estimate as a prior period adjustment. However, DFAS did not discuss our other recommended adjustments with the Office of the Under Secretary of Defense (Comptroller) and did not make the adjustments. The DFAS Indianapolis Center did not make our recommended adjustments because of the lack of examples and specific guidance in DoD Regulation 7000.14-R. We discussed this problem with accounting policy personnel in the Office of the Under Secretary of Defense (Comptroller), and they agreed to incorporate more specific guidance in DoD Regulation 7000.14-R for use in preparing the FY 2000 financial statements.

Overall Effect on Financial Statements

On the FY 1999 Other Defense Organizations financial statements, the DFAS Indianapolis Center reported a total of \$206.5 billion for the military retirement health benefits liability, including \$196.2 billion for long-term liability and \$10.3 billion for short-term liability. The military retirement health benefits liability was overstated by \$10.3 billion on the Balance Sheet. In addition, cumulative results of operations were overstated by \$6.4 billion on the Balance Sheet, and program costs were overstated by \$16.7 billion on the Statement of Net Cost.

Recommendations and Management Comments

1. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, record the overstatements in the military retirement health benefits liability and its related expense on the FY 1999 Other Defense Organizations-General Funds financial statements as a prior period adjustment for FY 2000.

Management Comments. The Defense Finance and Accounting Service concurred and stated that the Defense Finance and Accounting Service

Sustaining Forces – Indianapolis will correct the overstatement of the military retirement health benefits liability as a prior period adjustment for the FY 2000. The estimated completion date is November 15, 2000.

2. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, obtain specific accounting guidance from the Under Secretary of Defense (Comptroller) on how to treat and record the military retirement health benefits liability.

Management Comments. The Defense Finance and Accounting Service concurred and stated that the Defense Finance and Accounting Service will work with the Under Secretary of Defense (Comptroller) to develop better guidance for recording the military retirement health benefits liability. The estimated completion date is September 30, 2000.

Appendix A. Audit Process

Scope

Work Performed. This audit is part of the "Audit of the Compilation of Financial Data for Other Defense Organizations Into the FY 1999 DoD Agency-Wide Financial Statements" (Project No. D2000FA-0043). This audit focused on whether the FY 1999 military retirement health benefits liability was correctly reported on the FY 1999 Other Defense Organizations General Fund financial statements. For FY 1999, the Actuary, DoD, reported \$196.2 billion for the military retirement health benefits liability. We reviewed the FY 1999 Other Defense Organizations financial statements, related notes, and journal entries prepared by the DFAS Indianapolis Center in recording and reporting the FY 1999 military retirement health benefits liability.

Limitations to Scope. We did not review the management control program because it was discussed in prior audits relating to the military retirement health benefits liability. (See the Summary of Prior Coverage for reports on the liability.) The management control program for the compilation of financial data for Other Defense Organizations into the FY 1999 DoD Agency-Wide financial statements was discussed in IG, DoD, Report No. D-2000-103, March 16, 2000.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. (01-DoD-2)
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. (01-DoD-2.5)
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. (01-DoD-2.5.1.)
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. (01-DoD-2.5.2.)

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goal:** Improve data standardization of finance and accounting data items. (FM-4.4)
- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act of 1982. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the Department of Defense. This report provides coverage of the Defense Financial Management high-risk area.

Methodology

Use of Computer-Processed Data. We relied on computer-processed data from the DFAS Indianapolis Center to determine whether the military retirement health benefits liability was correctly reported on the FY 1999 Other Defense Organizations financial statements and related notes. We did not validate the reliability of the computer-processed data because we limited our use of the data to determining the adequacy of the coordination between the DFAS Indianapolis Center and the Actuary, DoD. However, not validating the reliability of DFAS computer-processed data did not materially affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from January through February 1999 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD.

Contacts During the Audit. We visited or contacted organizations within DoD. Further details are available on request.

Summary of Prior Coverage

The General Accounting Office and the IG, DoD, have conducted multiple reviews related to financial statement issues. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. IG, DoD, reports can be accessed on the Internet at <http://www.dodig.osd.mil>. The IG, DoD, has issued three audit reports on the military retirement health benefits liability:

-
- IG, DoD, Report No. D-2000-090, "Inpatient Data Supporting the DoD Military Retirement Health Benefits Liability Estimate," March 1, 2000.
 - IG, DoD, Report No. 99-127, "Data Supporting the FY 1998 DoD Military Retirement Health Benefits Liability Estimate," April 7, 1999.
 - IG, DoD, Report No. 99-010, "DoD Military Retirement Health Benefits Liability for FY 1997," October 13, 1998.

Appendix B. Accounting Transactions for Recording the Military Retirement Health Benefits Liability

The following is a summary of the results of accounting transactions prepared by the DFAS Indianapolis Center to record the military retirement health benefits liability estimate for FY 1999. A table on the last page of this Appendix shows the accounting transactions prepared by the DFAS Indianapolis Center and transactions recommended by the IG, DoD.

Reestablishing the Liability. The DFAS Indianapolis Center had not established a permanent liability account for military retirement health benefits. Therefore, the DFAS Indianapolis Center had to reestablish the liability every year. Transactions A and B, prepared by the DFAS Indianapolis Center, were to record the prior year ending balance as current year beginning balance. Our recommended transaction A, on the last page of this Appendix, was the only transaction necessary to reestablish the liability.

Prior Period Adjustment. The DFAS Indianapolis Center initially failed to classify the decrease in FY 1998 liability estimate as a prior period adjustment. To record the decrease in actuarial liability, transaction C from the DFAS Indianapolis Center misclassified the decrease in the FY 1998 liability estimate as an FY 1999 current operating expense on the FY 1999 Statement of Net Costs. On approval from the Under Secretary of Defense (Comptroller), the DFAS Indianapolis Center prepared transaction F in an attempt to record the change in FY 1998 liability as a prior period adjustment. However, because the DFAS Indianapolis Center did not record transactions to correct the FY 1999 current operating expense on the Statement of Net Costs, the prior period adjustment was recorded incorrectly. Our recommended transaction C properly recorded the decrease in FY 1998 liability estimate as a prior period adjustment.

FY 1999 Retirement Health Benefits Expense. Transaction D, prepared by the DFAS Indianapolis Center, attempted to record the current year benefits expense. However, transaction D from the DFAS Indianapolis Center incorrectly increased other accrued liabilities and should not have been posted to cumulative results of operations. Our recommended transaction D properly recorded the current year benefits expense.

FY 1999 Benefits Payment. The DFAS Indianapolis Center failed to record the FY 1999 benefits payment of \$6.4 billion as a reduction to the liability and an adjustment to the benefits expense that was recorded in the prior year. We recommended transaction E to properly account for the FY 1999 benefits payment.

As a result of the transactions by the DFAS Indianapolis Center, the military retirement health benefits liability was overstated by \$10.3 billion on the Balance Sheet, cumulative results of operations was overstated by \$6.4 billion on the Balance Sheet, and program costs were overstated by \$16.7 billion on the Statement of Net Cost, as reported on the FY 1999 Other Defense Organizations financial statements.

Appendix C. Report Distribution

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Defense Finance and Accounting Service Comments



DFAS-HQ/ASF

DEFENSE FINANCE AND ACCOUNTING SERVICE

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APR 26 2000

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Audit of the Reporting of the FY 1999 Military Retirement Health Benefits Liability
in the DoD Financial Statements (Project No. D2000-D000FA-0643.002)

Our response to the subject audit is attached. The primary point of contact (POC) is
Mr. Wayne Ebaugh, (703) 607-2857 or DSN 327-2857, and the secondary POC is Mr. Mike
Bryant, (703) 607-1562 or DSN 327-1562.


Edward A. Harris
Director for Accounting

Attachment:
As stated

cc:
DFAS-HQ/DI
DFAS-IN/XP

DFAS Comments on Audit of the Reporting of the FY 1999 Military Retirement Health Benefits Liability in the DoD Financial Statements (Project No. D2000-D000FA-0043.002)

Responses to Recommendations

Recommendation 1. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, record the overstatements in the military retirement health benefits liability and its related expense on the FY 1999 Other Defense Organizations General Fund financial statements as a prior period adjustment for next year.

DFAS Management Comments: Concur. The Defense Finance and Accounting Service (DFAS) incorrectly booked the adjustment to the military retirement health benefits liability in the Fiscal Year (FY) 1999 Other Defense Organizations General Fund financial statements. The Office of the Inspector General, Department of Defense (DoDIG), discovered the error and provided DFAS the recommended adjustments to the accounts. The DFAS Sustaining Forces - Indianapolis will correct the overstatement of the military retirement health benefits liability as a prior period adjustment for the FY 2000 audited financial statements reporting and coordinate with Treasury on the correct presentation for FACTS I reporting for FY 2000.

Estimated Completion Date: November 15, 2000.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, obtain specific accounting guidance from the Under Secretary of Defense (Comptroller) on how to treat and record the military retirement health benefits liability.

DFAS Management Comments: Concur. The DoDIG has discussed with the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) the lack of examples and specific guidance in DoD FMR 7000.14 regarding the accrual of the military retirement health benefits liability. DFAS will work with OUSD(C) to develop better guidance for recording the military retirement health benefits liability.

Estimated Completion Date: September 30, 2000.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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Charles J. Richardson
Walter R. Loder
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D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 08/29/00

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.